

1 ADAM A. LEWIS (BAR NO. 88736)
ALewis@mofo.com
2 VINCENT J. NOVAK (BAR NO. 233003)
VNovak@mofo.com
3 KRISTIN A. HIENSCH (BAR NO. 275676)
KHiensch@mofo.com
4 MORRISON & FOERSTER LLP
425 Market Street
5 San Francisco, California 94105-2482
Telephone: (415) 268-7000
6 Facsimile: (415) 268-7522

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8 Attorneys for Secured Creditor
SAN JOSE TOWERS CORP.

9 UNITED STATES BANKRUPTCY COURT
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN JOSE DIVISION

12 *In re:*

Case No. 11-58944-SLJ-11

13 Community Towers I, LLC,
a Delaware limited liability company,
Employer Tax I.D. No.: 75-2456729,

Case No. 11-58945-SLJ-11

14 Community Towers II, LLC,
15 a Delaware limited liability company,
Employer Tax I.D. No.: 75-2560662,

Case No. 11-58948-SLJ-11

16 Community Towers III, LLC,
17 a Delaware limited liability company,
Employer Tax I.D. No.: 32-0065635,

Case No. 11-58949-SLJ-11

18 Community Towers IV, LLC,
19 a Delaware limited liability company,
Employer Tax I.D. No.: 77-0379075,

Cases Jointly Administered

Chapter 7

20 Debtor(s).

SAN JOSE TOWERS CORP.'S REPLY IN
SUPPORT OF ITS MOTION FOR
RECONSIDERATION OF AWARD IN
ORDER RE: TURNOVER OF CASH
COLLATERAL

21 111 W. Saint John Street, Suite 705
22 San Jose, California 95113

23
24 Date: April 9, 2014
Time: 2:00 p.m.
25 Place: Honorable Stephen L. Johnson
26 280 S. First Street, Room 3099
San Jose, CA 95113

27
28 SAN JOSE TOWERS CORP.'S REPLY RE
MOTION FOR RECONSIDERATION

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1 San Jose Towers Corp. (“SJTC”), successor-in-interest to the rights of CIBC Inc.
2 (“CIBC”) in connection with these cases, files this reply (this “Reply”) in support of its *Motion*
3 *for Reconsideration of Award in Order re: Turnover of Cash Collateral* (filed February 3, 2014,
4 Dkt. No. 370) (the “Motion to Reconsider”).¹ This Reply addresses the *Chapter 7 Trustee’s*
5 *Opposition to San Jose Towers Corp.’s Motion for Reconsideration of Order Granting in Part*
6 *and Denying in Part Motion for Turnover of Cash Collateral* (filed March 26, 2014, Dkt No. 378)
7 (the “Opposition”).

8 I. PRELIMINARY STATEMENT

9 By the Motion to Reconsider, SJTC sought reconsideration of this Court’s *Order*
10 *Granting in Part and Denying in Part Motion for Turnover of Cash Collateral* (entered
11 January 21, 2014, Dkt. No. 360) (the “Order”), pursuant to Rule 59(e) of the Federal Rules of
12 Civil Procedure, as incorporated by Rule 9023 of the Federal Rules of Bankruptcy Procedure (the
13 “Bankruptcy Rules”). Specifically, SJTC asked this Court to recalculate its award to SJTC of
14 \$377,992 in the Order based on manifest error of law or fact, and in order to avoid manifest
15 injustice, on the grounds that (1) the Court did not rule on SJTC’s argument that the Debtors’
16 unencumbered cash should be presumed to have been spent first, (2) the Court did not rule on
17 SJTC’s argument that, at the very least, the Debtors’ funds should be deemed spent in proportion
18 to their respective shares of those funds, (3) the Court’s award excluded certain additional funds,
19 which were unknown at the time, that should have been deemed to be SJTC’s cash collateral, and
20 (4) SJTC’s security interest, though unperfected, was no longer subject to avoidance.

21 In the Opposition, the Chapter 7 Trustee (the “Trustee”) has urged this Court to deny the
22 Motion to Reconsider on various grounds, advocating generically that the generalized interest in
23 the finality of judgments outweighs any losses that SJTC may suffer as a result of the inadequate
24 award. This appeal to finality plainly disregards the well-settled line of cases permitting a court
25 to revisit its prior rulings whenever required in the interest of justice, and particularly where, as

26
27 ¹ Capitalized terms used herein but not otherwise defined shall have the meanings given
28 them in the Motion to Reconsider or the Opposition, as applicable.

1 here, there is a manifest error of fact or law that would prejudice a party's rights (not to mention
2 that the Order is not yet final because of the filing of the Motion to Reconsider, per Bankruptcy
3 Rule 8002(b)²).

4 As to SJTC's first two arguments above, the Trustee argued that the Court already
5 "squarely addressed" the arguments and that there is insufficient evidence or law to support the
6 arguments in any event. This is wrong for two reasons. First, there is ample support in the record
7 for this Court to conclude that all of the Debtors' prepetition unencumbered funds were spent in
8 the ordinary course of the Debtors' operations by as early as April 2013, and that all subsequent
9 funds thus constituted SJTC's collateral. There is similar support for SJTC's proportionality
10 argument. Second, the Court, by holding that it would not address the arguments, nevertheless
11 *sub rosa* adopted the Trustee's (and Debtors') view.

12 The Trustee also contends, among other things, that the Court's various calculations
13 should not be revisited, or if they are, that the Trustee's own calculations are more accurate than
14 the Debtors' accounting reflected in the Debtors' monthly operating reports. However, as will be
15 shown below, each of the Trustee's calculations either lacks support or otherwise second-guesses
16 the Debtors' accounting in a way that conveniently benefits the Trustee. Furthermore, the Trustee
17 makes various arguments about why he believes that SJTC's liens on the cash collateral should be
18 invalidated. But, as shown below, these arguments must fail. SJTC thus urges this Court to
19 reconsider its Order as set forth in the Motion to Reconsider.

20 II. STANDARD

21 The Opposition makes much of the argument that Rule 59(e) is an "extraordinary remedy"
22 to be granted only under "highly unusual circumstances," and that the generalized interest in
23 finality of decisions should trump the losses that SJTC has suffered as a result of the calculation
24 issues and other problems evident in the Order. (Opposition at 3-4.) To that end, the Opposition
25 suggests that the relief SJTC has sought in the Motion to Reconsider would result in a "windfall

26 ² See also LAWRENCE P. KING, COLLIER ON BANKRUPTCY (16th ed. 2014) at 9023.07 (a
27 motion to reconsider "will suspend the finality of the judgment for the purposes of appeal").
28

1 or unjust benefit” for SJTC, contending that because CIBC, SJTC’s predecessor, received
2 adequate protection payments during the course of the bankruptcy case and foreclosed on
3 property that CIBC valued at \$34.1 million, SJTC has already received enough. But this line of
4 argument turns a blind eye to the facts of this case.

5 The fact is that SJTC’s claim against the Debtors’ bankruptcy estate was for *at least*
6 \$39,883,466,³ only \$22.5 million of which was satisfied through SJTC’s credit bid of its debt at
7 the foreclosure sale of the Property, thereby leaving SJTC with a considerable deficiency claim.
8 And even assuming that SJTC received additional value above and beyond the \$22.5 million
9 when it took title to the Property, and assuming that CIBC’s prior appraisal of \$34.1 million is
10 still accurate (which remains to be seen and is entirely subject to market conditions), there
11 nevertheless remains a considerable difference—potentially millions of dollars—between SJTC’s
12 claims and the value it has received. Moreover, the adequate protection payments were applied to
13 debt or nondefault interest; they were not gifts. The argument that SJTC somehow would receive
14 a “windfall” by receiving its due in additional cash collateral is specious at best.

15 In any event, the cases are clear that the interest in finality of judgments is to be
16 “balance[d] . . . against ensuring a just decision.” *Robinson v. Wix Filtration Corp. LLC*, 599
17 F.3d 403, 413 (4th Cir. 2010); *Venegas-Hernandez v. Sonolux Records*, 370 F.3d 183, 190 (1st
18 Cir. 2004) (applying Rule 59(e)). Reconsideration of a prior order is appropriate to prevent
19 “manifest injustice,” which in this case means preventing SJTC from suffering hundreds of
20 thousands of dollars in additional losses resulting from errors in the Order. *In re Greco*, 113 B.R.
21 658, 644 (D. Haw. 1990), *aff’d sub nom. Greco v. Troy*, 952 F.2d 406 (9th Cir. 1991).
22 Reconsideration is thus clearly proper here.

23
24
25
26 ³ See generally *CIBC’s Opposition to the Debtors’ Brief in Support of Their Objection to*
27 *Claim Nos. 4, 5, 6 and 7 (CIBC Inc.)* (filed October 30, 2013, Dkt. No. 328).

1 **III. ARGUMENTS**

2 **A. SJTC's Arguments 1 and 2 Are Supported by the Record**

3 The Trustee argues that the Court “squarely addressed” the “tracing argument” and
4 expressly declined to rule on SJTC’s contentions, due to a purported lack of supporting evidence
5 and law, that (1) the Debtors’ unencumbered cash should be presumed to have been spent first,
6 and (2) at the very least, the Debtors’ funds should be deemed to have been spent in proportion to
7 their respective shares of those funds. This is insupportable.

8 Rather, by expressly declining to rule on SJTC’s arguments, the Court actually (if
9 unintentionally) implicitly adopted the contrary position—that the Debtors spent CIBC’s money
10 in the operation of their business *first* before resorting to unencumbered funds, an inequitable
11 position for which there is no support. The Trustee has argued that this is the correct result,
12 implying that SJTC has failed to satisfy its burden of “tracing” the encumbered and
13 unencumbered funds in order to demonstrate which funds were spent when. This argument
14 unnecessarily complicates the calculation before this Court, however.

15 Indeed, there is ample evidence in the record that all of the Debtors’ original
16 unencumbered cash should be deemed to be spent first, which the Court can conclude without
17 conducting an unnecessarily complicated tracing analysis. The answer lies in the Debtors’ Master
18 Monthly Operating Reports (“MOR”). We know from the Debtors’ December 2011 MOR (Dkt.
19 No. 88) that the Debtors had spent \$1,310,957 during the course of the cases through December
20 2011 (December 2011 MOR at 3, line item 3b, rightmost column). The evidence also shows that
21 the Debtors had cash in accounts as of the petition date totaling \$808,238 (October 2011 MOR,
22 Dkt. No. 73 at 3, line 3d, rightmost column), which this Court ruled in the Order is unencumbered
23 cash. Thus, the Debtors began the case with \$808,238 and within three months had spent slightly
24 more than that, \$1,310,957. There is simply no evidentiary gap here—the evidence plainly
25 demonstrates that, by December of 2011, the Debtors had spent at least an amount equal to the
26 amount they had on the petition date.⁴

27 ⁴ Even if, as the Trustee contends, the Debtors instead had \$853,673.39 in their accounts
28 on the petition date rather than \$808,238, or \$807,474.48 as indicated in the Debtors’ schedules
(Footnote continues on next page.)

1 The Debtors previously argued that the cash collateral stipulation that the Debtors entered
2 into with CIBC (Dkt. No. 56-1), which permitted the Debtors to use CIBC's cash collateral
3 subject to various budgetary and other constraints, demonstrates that the cash the Debtors used in
4 their operations actually consisted of CIBC's cash rather than their own. However, the stipulation
5 very plainly provided that the Debtors were merely "authorized" to use CIBC's cash collateral—
6 nowhere in the stipulation did it require the exhaustion of CIBC's cash collateral prior to
7 spending unencumbered funds.⁵ (*Id.* at 2.)

8 In light of this Court's ruling in the Order that the Debtors' prepetition funds were not
9 subject to CIBC's (and now SJTC's) lien, however—and if the Court rejects SJTC's argument
10 that it continues to have an enforceable lien on the prepetition funds as discussed in Section III.E.,
11 *infra*—then the only proper conclusion is that those unencumbered funds will have been used first
12 prior to tapping into CIBC's cash. This is supported by simple logic, if nothing else; after all, the
13 spent funds must be *someone's* (if indeed there is an unencumbered component), and equity
14 dictates that the unencumbered funds must have been spent first. *See, e.g., In re Dowco*
15 *Petroleum, Inc.*, 137 B.R. 207, 210 (Bankr. E.D. Tex. 1992) ("If the estate contains enough
16 unencumbered funds to satisfy administrative claims, no justification exists for priming a taxing
17 entity's otherwise valid lien") (illustrating comparable principle codified in connection with tax
18 liens). Any contrary result would be improper, and indeed neither the Trustee nor the Debtors
19 have advanced any support, either in the form of case law or even persuasive reasoning, for
20 another result. SJTC's proportionality argument is offered as an equitable compromise as an
21 alternative, but that too is supported by ample evidence in the record. (*See* Motion to Reconsider
22 at 4.)

23 (Footnote continued from previous page.)

24 (Opposition at 11), the outcome remains the same. This minor discrepancy, if indeed it is valid,
25 does not change the calculus—all prepetition funds were spent by the end of the first year.

26 ⁵ In any event, CIBC took the position at that time that *all* of the Debtors' existing cash
27 was subject to its lien. Had the Debtors contended that any cash existing at as of the petition date
28 was unencumbered, CIBC surely would have made crystal clear that the Debtors were required to
exhaust those funds first before using CIBC's cash.

1 **B. Reconsideration of the Court’s Calculations is Proper**

2 In the Motion to Reconsider, SJTC demonstrated that the MOR for June of 2013 (Dkt. No.
3 295) shows a month-ending cash balance of \$668,109 and that, notwithstanding the arguments
4 stated above, this demonstrates with clarity the absolute maximum amount that could have
5 constituted the Debtors’ unencumbered funds.

6 The Trustee has advanced a number of arguments why this simple logic should be
7 rejected. First, the Trustee asserts that this argument is somehow “new” and thus cannot be
8 asserted under the circumstances. (Opposition at 7-8.) In so arguing, however, the Trustee is
9 modifying a general principle that remains wholly subject to this Court’s discretion. As noted in
10 the Motion to Reconsider, a motion for reconsideration may indeed seek relief based upon
11 evidence already in the record even if the moving party did not make that argument at trial. *See,*
12 *e.g., HSBC Bank, USA, Nat’l Ass’n v. United Airlines, Inc. (In re UAL Corp.)*, 360 B.R. 780, 784
13 (Bankr. N.D. Ill. 2007); *Fisher v. Hamilton (In re Teknek, LLC)*, 343 B.R. 850, 865 (Bankr. N.D.
14 Ill. 2006). *See also Williams v. Poulos*, 11 F.3d 271, 289 (1st Cir. 1993) (“The decision to grant
15 or deny a Rule 59 motion is committed to the wide discretion of the district court [T]his
16 discretion attaches to a court's decision on whether to allow a party to argue new material or a
17 new theory under Rule 59.”). In any event, this is not a “new” argument—SJTC’s original reply
18 brief (filed December 18, 2013, Dkt. No. 347) (the “Turnover Reply”) in support of its *Motion for*
19 *Turnover of Cash Collateral and Accounting* (filed November 22, 2013, Dkt. No. 334) (the
20 “Turnover Motion”) extensively discussed the question of how much unencumbered funds
21 remained and when they had been spent. (*See Turnover Reply* at 3-4.)

22 Next, the Trustee has argued that the Debtors’ MORs are unreliable because they conflict
23 with calculations made by the Trustee’s accountant. Specifically, the Trustee argued that the cash
24 balance at the end of June 2013 was not \$668,109, as represented to the Court by the Debtors in
25 the June 2013 MOR. Instead, the Trustee argues, the ending cash balances in the Debtors’ bank
26 accounts purportedly totaled \$926,738.35 at that time, and that the Debtors had improperly
27 adjusted the accounts downward due to the issuance of outstanding, uncashed checks totaling
28 \$249,507.24. (Opposition at 8.) This attempt by the Trustee to second-guess the Debtors’

1 accounting decisions and to add back in the amounts represented by the uncashed checks is
2 flawed, however, because the checks could have been cashed at any time and the funds
3 represented by those checks were committed to the third-party recipients of those checks. The
4 Debtors' MOR thus represented a more realistic picture of the Debtors' finances at the time.

5 The Trustee further argues that the amounts turned over to the Trustee from the Debtors
6 upon conversion of the case totaled \$1,312,856.60, which the Trustee argued is more accurate
7 than the \$1,338,730 appearing in the December 2013 MOR. This argument, too, is flawed. The
8 December 2013 MOR serves as a reasonable reference point for purposes of this calculation
9 (incidentally, a reference point close in time to the time of the issuance of the Order, entered
10 December 13, 2013). By contrast, the Trustee has argued that the calculation of the turnover
11 amount should be as of the time of *conversion* of the case, which occurred on January 24, 2014
12 (*see* Dkt. No. 364). The difference between the Trustee's figure and that reflected in the MOR is
13 that the Trustee's figure reflects the subtraction of \$32,699.99 in various fees and a check issued
14 to the Debtors' management company, all deducted prior to the Debtors turning over the funds to
15 the Trustee. (*See* Crom Decl. ¶ 4.) The Trustee's selection of an arbitrary date over a month after
16 the issuance of the Order, after further expenditure of fees and expenses (all of which, notably,
17 were paid from *SJTC's own cash collateral*), and long after the Debtors no longer had the right to
18 use CIBC's cash collateral once it foreclosed on November 5, 2013, should not affect this Court's
19 calculation. After all, what is to stop the Trustee from deducting even further expenses post-
20 conversion incurred by the Trustee? Should the Trustee select a snapshot date as of, say, April 1,
21 or May 1, when the amounts in the Trustee's bank accounts (containing SJTC's cash collateral)
22 will surely be even lower then? SJTC submits that the proper date for purposes of this Court's
23 calculation is the December MOR and not the date of conversion.

24 C. The Trustee is Not Entitled to Surcharge SJTC's Collateral

25 The Trustee further argued that he may surcharge SJTC's collateral under section 506(c)
26 for expenses incurred in operating and preserving the Property, arguing that the expenses incurred
27 were reasonable, necessary, and benefited CIBC/SJTC. (Opposition at 9-10.) This argument too
28 is meritless. First and foremost, CIBC (and, thus SJTC) has already effectively been surcharged

1 for the preservation and protection of the collateral throughout the case through the cash collateral
2 stipulations with the Debtors (*see, e.g.*, Dkt. No. 56). Pursuant to the stipulations, CIBC agreed to
3 permit the Debtors to use CIBC's cash collateral throughout the bankruptcy case, foregoing
4 CIBC's bargained-for contractual interest rate and other benefits negotiated in the underlying loan
5 documents. By this arrangement, CIBC and the Debtors agreed upon a way for the Debtors to
6 remain in operation for the benefit of creditors generally, at significant cost to CIBC. In short,
7 CIBC/SJTC itself already largely paid for the Debtors' operations through its cash collateral. To
8 attempt to surcharge SJTC's collateral now would deprive it of the benefit of its bargain, and
9 disregards any losses that CIBC may already have suffered while it permitted the Debtors to
10 continue using its cash collateral.

11 Additionally, while SJTC certainly preferred that the Debtors maintain ordinary-course
12 operations rather than delivering an empty building upon foreclosure, the expenses that the
13 Debtors incurred in operating the business were certainly not for the *exclusive* benefit of CIBC—
14 all of the creditor constituencies (and, indeed, the Debtors' insiders) benefited from the Debtors
15 continuing to maintain operations and continuing to generate income. By the Trustee's logic, any
16 time a debtor spends funds keeping its business afloat, each and every charge incurred in the
17 course of its operations would arguably benefit a lender with a blanket lien on the business. The
18 Trustee goes too far with this argument. In any event, it is clear that the case was not filed for the
19 benefit of CIBC, but solely for the potential benefit of unsecured creditors (and the Debtors'
20 equity holders). Furthermore, it is important to note that the Trustee has not moved for a
21 surcharge under section 506(c), but simply argued that he *can*.

22 Finally, on the indisputable facts of these cases, it is clear that even were the estates to
23 retain all of the prepetition funds, there will not be enough money even to pay the expenses of
24 administration, which are and will be primarily professionals' fees in the chapter 7 and 11 phases
25 of the cases. To recover under section 506(c), the Trustee must prove that the underlying costs
26 were "incurred for the benefit of the secured creditor and be reasonable and necessary." *Poonja*
27 *v. Alleghany Props. (In re Los Gatos Lodge, Inc.)*, 278 F.3d 890, 893 (9th Cir. 2002). Moreover,
28 the benefit to the secured creditor must be direct and quantifiable. *Golden v. Chi. Title Ins. Co.*

1 (*In re Choo*), 273 B.R. 608, 611-13 (B.A.P. 9th Cir. 2002). Fees and costs of the Debtors'
2 professionals (and of the Trustee's, for that matter) are not recoverable under section 506(c),
3 particularly when they have been incurred at loggerheads with CIBC, and now SJTC, because
4 they do not benefit such a secured creditor. *Gen. Elec. Credit Corp. v. Levin & Weintraub (In re*
5 *Flagstaff Foodservice Corp.)*, 739 F.2d 73, 76-77 (2d Cir. 1984). Since the only parties that stand
6 a chance of being paid in these cases are the expenses of administration of the professionals (and
7 perhaps some other administrative expenses, if any, that the Trustee can show benefited
8 CIBC/SJTC), it follows that the Trustee cannot use section 506(c) to surcharge SJTC's collateral.

9 **D. SJTC is Entitled to Post-October 2013 Rent Collections**

10 As set forth in the Motion for Reconsideration, the Order mistakenly omitted from its
11 calculation of SJTC's award cash flow arising from the Debtors' operations in November and
12 December. Here the Trustee does not contest SJTC's theory—effectively conceding the point—
13 but merely offers an alternate calculation of those figures. The Trustee first argues that the
14 Debtors' cash at the petition date of \$808,238, as reflected on the October 2011 MOR,⁶ was
15 actually \$853,673.39 as purportedly reflected in the Debtors' bank statements. (*See* Crom Decl.
16 ¶3.) However, the Trustee relies solely on an unsupported statement by his accountant, Jay
17 Crom, who failed to attach to his declaration a copy of the referenced account statement for this
18 Court's consideration and otherwise made no attempt to reconcile or explain the difference.
19 Nowhere does Mr. Crom attempt to provide any further information about his calculation of the
20 \$853,673.39 other than ask this Court to take his word that this is what the "Debtors' bank
21 statements confirm." (*Id.*)

22 To the extent that the Trustee expects this Court to adopt Mr. Crom's assertion of the
23 Debtors' cash balance as of the Petition Date over what is reflected in the Debtors' MOR or
24 schedules, which were filed before this Court, SJTC submits that Mr. Crom's assertion is
25 objectionable under Rule 1002 of the Federal Rules of Evidence in that the best evidence of what

26 _____
27 ⁶ The Trustee notes that the Debtors' Amended Schedule B reflected cash at the Petition
28 Date of \$807,474.48, a negligible difference.

1 the Debtors' account statements reflect is copies of the account statements themselves. As to the
2 Trustee's reliance on the \$1,312,856.60 figure in his calculations, *see* Section III.B. above.

3 Accordingly, taking into account the post-October 2013 rent collection, SJTC's award
4 should be at least \$530,492 (\$1,338,730 less \$808,238), and not \$459,183.21 as the Trustee
5 advocates (which is itself an admission that the \$377,992 award was too low).

6 E. SJTC's Security Interest Is Enforceable

7 The Trustee argues that CIBC's lien was unperfected perpetuation, that the estate therefore
8 has the power to avoid the lien under section 544(a)(1), and that it need not actually avoid the lien
9 because its rights are superior without a judicial adjudication. (Opposition at 13:6-15:7.)
10 Although the Trustee may be right about the first two propositions above, he is wrong about the
11 third. Unperfected liens are avoidable but not void *ab initio* under section 544(a)(1). *Brady v.*
12 *Andrew (In re Commercial W. Fin. Corp.)*, 761 F.2d 1329, 1337-38 (9th Cir. 1985). The Trustee
13 must therefore avoid the lien under section 544(a)(1). Moreover, to do this, he must file an
14 adversary proceeding. *Id.* But he cannot do so because, as noted in the Motion to Reconsider, it
15 is too late for him to bring an action under that Code provision.

16 The cases cited by the Trustee are not to the contrary. In *SK PM Corp., Inc. v. Sharp (In*
17 *re SK Foods, L.P.)*, 2013 WL 6488275 (B.A.P. 9th Cir. 2013), an opinion that the issuing court
18 expressly declared on its first page was not for publication and therefore had no precedential
19 value, one of the very issues in the case was whether the stock transfer at issue was unperfected
20 and therefore avoidable under section 544(a)(3). This is the polar opposite of asserting that an
21 avoiding action is not required. Thus, even if it involved section 544(a)(1), it is inapplicable to
22 the current issue. And *Lonely Maiden Prods., LLC v. Goldentree Asset Mgmt., L.P.*, 201 Cal.
23 App. 4th 368 (2011), is a state court case addressing only state law. It does not discuss section
24 544(a)(1) and what procedures may be necessary to enforce the rights it grants at all.

25 In a related argument, the Trustee asserts based on *Matter of Meredosia Harbor &*
26 *Fleeting Serv., Inc.*, 545 F.2d 583, 590 n.15 (7th Cir. 1976), that he does not have to bring an
27 avoidance action because he already has the funds in this hands. (Opposition at 15:8-16:2.) But
28 *Meredosia Harbor* is inapropos for two reasons. First, it is simply a case of the bankruptcy

1 trustee employing the predecessor of Code section 502(d) (*see infra*) as an affirmative defense to
2 a proof of claim. Second, even if the case stood for what the Trustee claims, it should not be
3 followed. As interpreted by the Trustee, it confuses the concepts of avoidance under section
4 544(a)(1) and recovery of an avoided transfer under Code section 550. Clearly, the Trustee need
5 not *recover* property already in his possession, but he must still first *avoid* the transfer of the
6 security interest in that property.

7 The Trustee contends that he can raise the alleged avoidability of the CIBC lien on the
8 account as an affirmative defense even though the limitations period for an action under section
9 544(a)(1) has expired. This he can do, he says, because case law allows him to employ section
10 502(d) to disallow a claim on the grounds that CIBC and as successor, SJTC, have failed to return
11 an avoidable transfer under section 544(a)(1). (Opposition at 16:3-10.) But the problem with that
12 is that section 502(d) is a defense to the allowance of a claim, by its own terms. It expressly
13 provides that when the creditor has failed to return an avoidable transfer, “the court shall
14 *disallow*” that creditor’s claim. (Emphasis added.)

15 But this is not a claim objection proceeding at which the allowance or disallowance of
16 SJTC’s claim is at issue. Such a proceeding is commenced by motion under Bankruptcy Rules
17 3007(a) and 9014, and Local Bankruptcy Rule 3007-1. *See, e.g., In re Mouzon Enters., Inc.*, 610
18 F.3d 1329, 1334 (11th Cir. 2010) (claim objection proceeding is contested matter under Rule
19 9014). And indeed, there is such a proceeding pending in these cases, but section 502(d) has not
20 made any appearance in them. (*See* Dkt. Nos. 325, 329 (Debtors’ claim objections and reply).)⁷
21 Instead, the Motion to Reconsider is the outgrowth of *CIBC’s Second Motion for Stay Relief*
22 (filed February 19, 2013, Dkt. No. 258) (the “Stay Relief Motion”), the result of which the
23 Turnover Motion sought to enforce. (*See, e.g.,* Dkt. No. 334-1 at 1:6-17 (describing genesis of
24

25 ⁷ In any case, an unavoidable lien rides through the bankruptcy. *See, e.g., In re Kanarkis*,
26 341 B.R. 33, 35 (Bankr. S.D. Cal. 2006) (citing to *Dewsnup v. Timm*, 502 U.S. 410 (1992)).
27 Here, SJTC’s lien on the bank account is unavoidable because the Trustee cannot bring an action
28 to avoid it now. Hence, SJTC’s lien will survive even disallowance of its claim, the only effect of
the latter being to prevent SJTC from sharing in the estate’s unencumbered assets, something
SJTC is not trying to do.

1 Turnover Motion as being the Debtors' refusal to turn over the cash collateral notwithstanding
2 stay relief).) The Stay Relief Motion clearly sought stay relief with respect to the rents and
3 profits and other cash held by the Debtors. (See Stay Relief Motion at 1:1-8.) The resulting order
4 just as plainly granted that relief. (See Dkt. No. 267.) And once again, incidentally, section
5 502(d) did not arise in the Stay Relief Motion proceedings. (See Dkt. No. 264 (Debtors'
6 opposition).) In short, section 502(d) simply is inapplicable to the present matter.

7 **F. The Equities Favor SJTC**

8 Citing to *Toso v. Bank of Stockton (In re Toso)*, 2007 WL 7540985 (B.A.P. 9th Cir. 2007)
9 and cases from the Fifth and Seventh Circuits, the Trustee argues that the "equities of the case"
10 language of Code section 552(b) permits a court to deny a secured creditor the postpetition
11 collateral section 552(b) otherwise created when awarding the collateral to a secured creditor
12 would be a windfall for it at the expense of the unsecured creditors. (Opposition at 16:11-17:24.)
13 The Trustee urges, "It [SJTC] seeks to reap all the benefits of the [Debtors'] post-petition
14 operations, but without having to pay the attendant costs of operating and preserving the Property
15 which allowed those post-petition rents to be generated." (Opposition at 17:16-18.) Accordingly,
16 the Trustee concludes, the Court should limit SJTC's recovery of even post-petition rents.

17 There are two glaring weaknesses in this theory. The first is that given the financial
18 circumstances of the estates, there is no chance that the unsecured creditors, whose interests the
19 Trustee is purporting to protect with this argument, will see a penny. Already the expenses of
20 administration of just the chapter 11 phase of the cases far exceed what is left in the estates
21 without regard to the outcome of the Motion for Reconsideration. On top of that will be the
22 Trustee's chapter 7 expenses of administration. The beneficiaries of this theory will not be the
23 general unsecured creditors, but the expense of administration claimants alone. The second, even
24 more profound infirmity with the Trustee's section 552(b) argument is its very premise: that
25 assets that "belonged" to the unsecured creditors were used for the benefit of CIBC and SJTC.
26 That is, of course, totally false. This Property was run on cash collateral stipulations with CIBC.
27
28

1 It was CIBC's collateral that was used to preserve and protect the Property.⁸ Indeed, if anything
2 is inequitable, as SJTC has argued, it is finding that the Debtors used CIBC's cash collateral when
3 they had their own unencumbered funds to use first.

4 **IV. CONCLUSION**

5 Accordingly, SJTC respectfully requests that this Court overrule the Opposition and
6 reconsider and correct the amount of cash collateral it awarded in the Order in accordance with
7 the Motion to Reconsider.

8 Dated: April 2, 2014

ADAM A. LEWIS
VINCENT J. NOVAK
KRISTIN A. HIENSCH
MORRISON & FOERSTER LLP

12 By: /s/ Vincent J. Novak
VINCENT J. NOVAK

14 Attorneys for Secured Creditor
SAN JOSE TOWERS CORP.

23 ⁸ Implicit in a portion of the argument is the notion that SJTC has already more than
24 recovered the amount of its claim so it is inequitable for SJTC to obtain the cash collateral that is
25 otherwise its. (*See* Opposition at 17:19-24.) But aside from the Trustee not having established
26 the facts he asserts, this argument overlooks a fundamental reality. Nothing in section 552(b)
27 authorizes the Court to take away SJTC's property to do what it may see as equity. As the
28 Trustee's own authorities reflect, the Court's power under section 552(b) is limited to making the
secured creditor pay for what benefited it at the expenses of general unsecured creditors (making
section 552(b) somewhat akin to section 506(c) on surcharging collateral); and as SJTC has just
shown, that concern is not present in these cases.

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6 **SAN JOSE TOWERS CORP.'S REPLY IN SUPPORT OF ITS
7 MOTION FOR RECONSIDERATION OF AWARD IN
8 ORDER RE: TURNOVER OF CASH COLLATERAL**

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<u>Chapter 7 Trustee</u> Fred Hjelmset fhtrustee@gmail.com CA90@ecfcbis.com	<u>United States Trustee</u> <u>Office of the United States Trustee (SJ)</u> Edwina E. Dowell Edwina.e.dowell@usdoj.gov
<u>Counsel for Chapter 7 Trustee</u> Daniel M. Linchey dlinchey@gsdllaw.com, jrose@gsdllaw.com; gsdlecf@gmail.com	<u>Attorneys for Debtors</u> John Walshe Murray Robert A. Franklin Thomas T. Hwang Robert A. Franklin: Franklin.Robert@Dorsey.com, bobf_94303@yahoo.com Thomas T. Hwang: Hwang.Thomas@Dorsey.com John Walshe Murray: murray.john@dorsey.com, jwmurray@murraylaw.com, johnwalshemurray@hotmail.com

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13 **Counsel for Debtors**

14 William L. Conti
15 Law Offices of William L. Conti
16 100 E. San Marcos Blvd #404
17 San Marcos, CA 92069

18 **Counsel for Debtors**

19 Eric Mogensen
20 Miller, Morton, Caillat and Nevis
21 50 W San Fernando St #1300
22 San Jose, CA 95113-2413

23 I declare under penalty of perjury that the above is true and correct.

24 Executed at San Francisco, California, April 2, 2014.

25
26
27
28

John Kline
(typed)

/s/ John Kline
(signature)